

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1952

No. 51

LIBRARY
SUPREME COURT, U.S.

F. DONALD ARROWSMITH AND RUTH B. BAUER,
EXECUTORS OF THE LAST WILL AND TESTA-
MENT OF FREDERICK B. BAUER, DECEASED,
AND RUTH BAUER, ET AL., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MAY 6, 1952

CERTIORARI GRANTED JUNE 9, 1952

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 51

F. DONALD ARROWSMITH, AND RUTH R. BAUER,
EXECUTORS OF THE LAST WILL AND TESTA-
MENT OF FREDERICK R. BAUER, DECEASED,
AND RUTH BAUER, ET AL., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

INDEX

	Original	Print
Proceedings in U.S.C.A. for the Second Circuit	1	1
Appendix to brief for appellant	1	1
Docket entries re Frederick R. Bauer and Ruth Bauer	1	1
Docket entries re Mary Stewart Vivian	2	2
Findings of fact and opinion, Van Fossan, J.	4	4
Decision re F. R. Bauer	9	8
Decision re M. S. Vivian	10	9
Appendix to brief for respondent	12	9
Opening statement on behalf of taxpayers	12	9
Opening statement on behalf of Commissioner	14	11
Extracts from Deficiency notice attached to petition in Bauer case	16	13
Extracts from Deficiency notice attached to petition in Vivian case	17	14
Stipulation of facts filed in Tax Court	17a	16
Opinion, Frank, J.	18	19
Judgment Bauer case	21	21
Judgment Vivian case	21	21
Petition for rehearing (omitted in printing)	23	
Order on rehearing	27	24
Order denying rehearing	27	24
Clerk's certificate (omitted in printing)	27	
Stipulation as to printing record	29	25
Order allowing certiorari	30	25

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JUNE 20, 1952.

[fol. 1]

[File endorsement omitted]

IN THE TAX COURT OF THE UNITED STATES**Appendix to Brief for Appellant—Filed August 6, 1951**

Docket No. 24393

FREDERICK R. BAUER and RUTH BAUER, Husband and Wife,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES**1949**

Aug. 3. Petition received and filed. Taxpayer notified. Fee paid.

Aug. 4. Copy of petition served on General Counsel.

Sep. 12. Answer filed by General Counsel.

Sep. 13. Request for Hearing in New York filed by General Counsel.

Sep. 21. Notice issued placing proceeding on New York calendar. Service of answer and request made.

1950

Mar. 29. Hearing set May 22, 1950—New York.

May 22. Hearing had before Judge Van Fossan on merits, consolidated with Dk. No. 24394 for hearing. Stipulation of facts with joint exhibits 1-A thru 6-F attached filed. Briefs, July 21, 1950. Replies Aug. 7, 1950.

Jun. 15. Transcript of Hearing 5/22/50 filed.

Jul. 13. Motion for leave to reopen and file supplemental stipulation of facts, supplemental stipulation of facts lodged, filed by petitioner. Granted Aug. 7, 1950.

Jul. 21. Brief filed by taxpayer. Copy served 7/24/50.

Jul. 21. Brief filed by General Counsel.

Dec. 14. Findings of fact and opinion rendered. Van Fossan J. Decision will be entered under Rule 50. Copy served.

[fol. 2] 1951.

Jan. 19. Agreed computation for entry of decision filed.

Jan. 23. Decision entered. Van Fossan J. Div. 9.

Apr. 18. Petition for review by U. S. Court of Appeals for the Second Circuit filed by General Counsel.

Apr. 18. Notice of filing petition for review sent to George R. Sherriff, taxpayer's counsel.

Apr. 30. Proof of service of petition for review filed by General Counsel.

May 18. Motion for extension to July 17, 1951 to prepare and transmit the record filed by General Counsel.

May 18. Order enlarging time to July 17, 1951 to prepare and transmit the record entered.

Jun. 25. Statement of Points filed by General Counsel with statement of service thereon.

Jun. 25. Designation of record filed by General Counsel with statement of service thereon.

Jun. 29. Certified copy of an order from the Second Circuit consolidating dockets 24393 and 24394 for the purpose of sending up a single record and that the exhibits A-1 thru G-F be transmitted in original form to the Clerk of the U. S. Court of Appeals ten days prior to hearing filed.

IN THE TAX COURT OF THE UNITED STATES

Docket No. 24394

MARY STEWART VIVIAN, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

1949

Aug. 3. Petition received and filed. Taxpayer notified. Fee paid.

Aug. 4. Copy of petition served on General Counsel.

Sep. 13. Answer filed by General Counsel.

[fol. 3] 1949

Sep. 13. Request for Hearing in New York filed by General Counsel.

Sep. 21. Notice issued placing proceeding on New York calendar. Service of answer and request made.

1950

Mar. 29. Hearing set May 22, 1950, New York.

May 22. Hearing had before Judge Van Fossan on merits, consolidated with Dk. No. 24393 for hearing. Stipulation of facts with joint exhibits 4-A thru 6-F attached, filed. Briefs, July 21, 1950. Replies Aug. 7, 1950.

June 15. Transcript of Hearing 5/22/50 filed.

Jul. 13. Motion for leave to reopen and file supplemental stipulation of facts, supplemental stipulation lodge, filed by petitioner. Granted 8/7/50.

Jul. 21. Brief filed by taxpayer. Copy served.

Jul. 21. Brief filed by General Counsel.

Dec. 14. Findings of fact and opinion rendered. Van Fossan, J. Decision will be entered under Rule 50. Copy served.

1951

Jan. 19. Agreed computation for entry of decision filed.

Jan. 23. Decision entered. Van Fossan, J. Div. 9.

Apr. 18. Petition for Review by U. S. Court of Appeals for the Second Circuit filed by General Counsel.

Apr. 18. Notice of filing petition for review sent to George R. Sherriff, taxpayer's counsel.

Apr. 30. Proof of service of petition for review filed by General Counsel.

May 18. Motion for extension to July 17, 1951 to prepare and transmit the record filed by General Counsel.

[fol. 4]

May 18. Order enlarging time to July 17, 1951 to prepare and transmit the record entered.

Jun. 25. Statement of points filed by General Counsel with statement of service thereon.

Jun. 25. Designation of record filed by General Counsel with statement of service thereon.

1951

Jun. 29. Certified copy of an order from the Second Circuit consolidating dockets 24393 and 24394 for the purpose of sending up a single record and that the originals of exhibits A-1 thru 6-F be transmitted to the Clerk ten days prior to the hearing filed.

FINDINGS OF FACT AND OPINION OF THE TAX COURT

(Caption omitted)

The respondent determined deficiencies in the petitioners' income tax liabilities for the year 1944 as follows:

Docket No.	Petitioner	Amount
24393	Frederick R. and Ruth R. Bauer	\$14,251.41
24394	Mary Stewart Vivian	8,057.10

The issue is whether a judgment paid by petitioners for a liquidated corporation, of which they were transferees, was a capital loss or an ordinary loss to them in the year of payment.

The proceedings were consolidated and submitted on a stipulation of facts, with exhibits attached. The stipulated facts are so found and are incorporated herein by this reference.

Findings of Fact

Petitioner, Mary Stewart Vivian, is an individual residing in Plainfield, New Jersey, and her income tax return [fol. 5] for the year 1944 was filed with the collector of internal revenue for the second district of New York. She was the wife of Davenport Pogue, who died on September 17, 1937. She married Leslie L. Vivian some time subsequent to 1940.

Petitioners, Frederick R. Bauer and Ruth R. Bauer, are husband and wife, residing at Lakeville, Connecticut. Their joint return for the year 1944 was filed with the collector of internal revenue for the second district of New York.

A corporation, known as Bauer, Pogue & Co., Inc., was organized in April 1933 under the laws of the State of Delaware. One-half of the stock of the corporation was

issued to Frederick R. Bauer, and one-half to Davenport Pogue. Upon the death of Davenport Pogue on September 17, 1937, one F. Donald Arrowsmith was appointed executor of his will and the 50 per cent share of the stock of the corporation belonging to Pogue was transferred to his estate.

The corporation began the first of a series of distributions in complete liquidation on or about December 15, 1937, and made further distributions in liquidation in the years 1938, 1939, and 1940. The last of the distributions in complete liquidation was made in 1940. All such distributions were made as follows: one-half thereof to Frederick R. Bauer, petitioner herein, and the other one-half, representing the shares formerly owned by Davenport Pogue, was distributed in 1937 and 1938 to the Estate of Davenport Pogue, deceased, and in 1939 and 1940 to his widow, Mary Stewart Pogue (now Vivian), petitioner herein, as heir of the Pogue estate.

In the case of the 50 per cent interest formerly owned by Davenport Pogue, no report of the liquidating dividend for 1937 was shown in the return of the Estate of Davenport Pogue, deceased, for that year, but the distribution for the [fol. 6] year 1938 was reflected in the income tax return of the Estate of Davenport Pogue, deceased, for that year. For the years 1939 and 1940 the liquidating dividends representing the Pogue interests paid to Mary Stewart Pogue (now Vivian) were reflected in her income tax returns.

The total liquidating distributions paid to each of the petitioners, Vivian and Bauer, during the years 1937 to 1940, inclusive, exceeded the sum of \$47,963.25.

On or about June 8, 1939, an action was commenced in the Supreme Court of the State of New York by Adele D. Trounstein as Ancillary Executrix of the Last Will and Testament of one Norman S. Goldberger as plaintiff, against Bauer, Pogue & Co., Inc., Frederick R. Bauer, and F. Donald Arrowsmith as Executor of the Last Will and Testament of Davenport Pogue, as defendants. This proceeding was transferred to the District Court of the United States for the Southern District of New York because of diversity of citizenship. The suit resulted in a judgment in

favor of the plaintiff therein, which decision was subsequently affirmed on appeal by the Circuit Court of Appeals in and for the Second Circuit. *Trounstone v. Bauer, Pogue & Co.*, 144 Fed. (2d) 379. Certiorari was thereafter applied for and denied. *Bauer, Pogue & Co. v. Trounstone*, 323 U. S. 777.

Thereafter, on December 11, 1944, after the judgment in the above proceeding had become final, each of the petitioners herein, Vivian and Bauer, was required to, and did, pay one-half of the judgment. The net amount of the judgment, after certain credits and adjustments, was in the amount of \$95,926.52, inclusive of interests and costs.

The distributions of liquidating dividends of the corporation to petitioner Frederick R. Bauer were reflected in his [fol. 7] income tax returns for the years 1937, 1938, 1939, and 1940 as capital transactions.

The distributions of liquidating dividends of the corporation to the Estate of Davenport Pogue, deceased in 1938, and to Mary Stewart Pogue (now Vivian) in 1939 and 1940, were reflected in the income tax returns of each of the distributees for said years, respectively, as capital transactions.

Petitioners in each case deducted the payment by each of the sum of \$47,963.25 as an ordinary loss in their respective income tax returns for the calendar year 1944.

Respondent determined that the payment by each petitioner of the sum of \$47,963.25 represented a capital loss deductible as provided by section 117 of the Internal Revenue Code.

OPINION

VAN FOSSAN, *Judge*: The issue is whether the judgment paid by petitioners for the corporation, of which they were transferees, was a capital loss or an ordinary loss to them in the year of payment.

The respondent contends that the payment of the judgment "grew out of, was related to, and took its character from a capital transaction, namely a long-term capital gain"

The respondent is aware that the case of *Stanley*

*Switlik*¹ appears contrary to his position here but he [fol. 8] contends that the case is distinguishable. The *Switlik* case and others preceding it were concerned with the payment by transferees of the transferor's taxes, whereas here, the transferees paid the amount of a judgment against their transferor. The respondent does not argue that the case is on that ground so distinguishable nor do we think so. Respondent attempts, however, to distinguish the *Switlik* case on the basis of circumstances surrounding the payment of the judgment. He points out that the petitioners were aware of the liquidation, that the payment of the resulting judgment might have been made before the last dividend in liquidation was paid and concludes that the judgment payments "cannot be dissociated in their ultimate character from the distributions in liquidation which such payments would have served to diminish." We fail to see a difference in principle between knowledge by transferees that they would be held on a judgment against their transferor and knowledge that a tax deficiency might be assessable against them.

Respondent contends further that the liquidation dividends were charged with a trust in favor of creditors and petitioners did not receive them "under claim of right and without restriction" as in the *Switlik* case. This trust fund theory lends no support to respondent's position. Insolvency, rather than knowledge of liquidation, is, by the general rule, the basis for the application of the trust fund doctrine, Mertens, *The Law of Federal Income Tax-*

¹ 13 T. C. 121, affd. (CA-3), 184 Fed. (2d) 299.

The stockholders of a corporation received distributions in complete liquidation in 1941 and each reported his pro rata share in his income tax return for that year as a long term capital gain. In 1944 the stockholders paid their liability as transferees for deficiencies in tax which the Commissioner, in 1942, determined the corporation owed for the years 1940 and 1941. It was held that the losses sustained by the stockholders as a result of payments made in 1944 were deductible in that year as ordinary losses and not as capital losses.

ation, Section 53.37, and insolvency of the transferor is not an element in this case. The respondent states that the petitioners as transferees "made no attempt to provide for this liability" and that a complete liquidation was made "leaving no assets in the hands of the corporation with which to meet the obligation" for the judgment. The [fol. 9] petitioner points out that under the provisions of section 115 (c) as it existed prior to the 1942 Act, the distributions could not be postponed but must be completed in 2 years in order to qualify as capital gains.

The respondent's remaining contentions reiterate his premise that the payment of the judgment was such a part of the capital transaction that it should not be regarded as an ordinary loss. Unless we regard the payment of a judgment as different in principle from a payment of taxes, this argument is to no avail and the issue is disposed of by the *Switlik* case. We see no need to revive or repeat the arguments raised therein since we are of the opinion that the case is not distinguishable. Any other view would multiply gossamer distinctions and ignore the harmonizing principle. Cf. *Roberta Pittman*, 14 T. C. 449, and *Seth M. Milliken*, 15 T. C. 243.

We hold that the payment by petitioners of the amount of a judgment against a corporation of which they were transferees was an ordinary loss to them in the year of payment.

Decisions will be entered under Rule 50.

IN THE TAX COURT OF THE UNITED STATES

Docket No. 24393

FREDERICK R. BAUER and RUTH R. BAUER, Husband and
Wife, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION—Entered January 23, 1951

Pursuant to the Findings of Fact and Opinion of the Court promulgated December 14, 1950, the parties herein

having filed an agreed computation of tax on January 19, 1951, it is

[fols. 10-11] Ordered and Decided: That there is a deficiency in income tax for the taxable year 1944 in the amount of \$292.12.

(Signed) ERNEST H. VAN FOSSAN, Judge.

Docket No. 24894

MARY STEWART VIVIAN, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION—Entered January 23, 1951

Pursuant to the Findings of Fact and Opinion of the Court promulgated December 14, 1950, the parties herein having filed an agreed computation of tax on January 19, 1951, it is

Ordered and Decided: That there is no deficiency in income tax for the taxable year 1944.

(Signed) Ernest H. Van Fossan, Judge.

[fol. 12]

**Appendix To Brief For Respondent—Filed
September 11, 1951**

IN THE TAX COURT OF THE UNITED STATES

OPENING STATEMENT ON BEHALF OF TAXPAYERS

(Respondents on Appeal).

Mr. Sheriff: Now, if your Honor please, these two cases both involve the same question. The issue is narrow. In each case the petitioner had to pay a judgment. Each paid one half of a certain judgment, arising out of the operation of a brokerage account. There is no question of the amount of the judgment. There is no question that each paid that judgment. There is no question that it is an allowable loss

to each one. The only question is whether it is a capital loss, rather than the ordinary loss which was claimed on the respective returns.

Now, in 1939, that is two years after Mr. Pogue died, but about two years before liquidation had been completed, though it had been started, a suit was started against Bauer, Pogue and Company, against Frederick R. Bauer, and against the Davenport Pogue estate, for an accounting by reason of the operation of a certain stock trading account. It was started by the executor of Norman Goldberger, deceased. The action was started in the Supreme Court of New York. Because of diversity of citizenship it was transferred to the Southern District Court of the Southern District of New York. The action was contested, and resulted after long proceedings in a judgment in favor of the plaintiff in that case. That suit was later appealed to the Circuit Court of Appeals and the judgment was affirmed. After that, an appeal or application was made to the Supreme Court for *certiorari*, which was denied in 1944. At that point of course the judgment became final and each petitioner, that is, Mr. Bauer and Mrs. Vivian, were required to pay one half of the judgment—I will give approximate figures—the judgment was approximately \$96,000, and when the judgment became final, Mr. Bauer [fol. 13] and Mrs. Vivian each had to pay approximately one half, or \$48,000.

They claimed the losses in their 1944 returns as ordinary losses from transactions entered into for profit, and while there is no question of the amount, or that they are entitled to the losses, the Government now says that they are only capital losses and not ordinary losses, because in earlier years they had been reflected in returns as capital gains, or capital transactions, and therefore in the later years, when the judgment had to be repaid, the Government seeks to limit them to capital loss.

Now, the petitioners' position is simply that this was a transaction entered into for profit, and that the way the matter was reported in the earlier years has no bearing upon the present year. Each year stands by itself. This

Court has already passed on the identical question in the case of *Stanley Switlik*, 13 T. C. 121, where it was held that the payment of the liability of the corporation in the latter year was an ordinary loss, even though the gain on the liquidation in earlier years had been reported as capital gain. That case, incidentally, was reviewed by the Court. I think there was one dissent, but not by your Honor. The case is now pending in the third Circuit, so far as I am advised, and has not been decided.

We submit that each year is entirely a separate transaction, as the Court held in the *Switlik* case and that the prior reporting has no bearing on the situation.

Official Report of Proceedings before the Tax Court of the United States, pages 3, 5, 6.

(File endorsement omitted.)

[fol. 14] IN THE TAX COURT OF THE UNITED STATES

OPENING STATEMENT ON BEHALF OF COMMISSONER

(PETITIONER ON APPEAL).

Mrs. Carlsen: Your Honor, as far as Respondent is concerned, Petitioners' counsel has made a fairly complete statement of our problem. The question in each case is whether the Commissioner erred in disallowing as an ordinary loss the payment by each petitioner in 1944 of one half of a judgment, which was rendered against a corporation, of which each petitioner was the distributee of half of the assets. Respondent has treated these transactions as a capital loss, as Petitioners' counsel has stated.

The evidence shows that, Petitioner Bauer reported his liquidating dividends from 1937 to 1940 as capital gains in his income tax returns, and in the case of Mrs. Vivian, she and her predecessor, her deceased husband's estate, likewise reported these liquidated dividends as capital transactions.

It is Respondent's contention in each instance that the taxpayer has merely sustained a capital loss; that the pay-

ment in each case grew out of and was related to and took its character from the original capital transaction; that actually it amounted to nothing more than a diminution of the original liquidating dividend and should be treated in the same manner. We wish to call your Honor's attention to the fact that the suit against the corporation and against Mr. Bauer was instituted before the liquidating dividends were completely distributed and of course in the event that it had gone to judgment these payments would have been deducted, and each of these petitioners would have received accordingly less amount to report as a capital gain.

However, it happens that the case dragged on and on and went through several courts and it was not finally terminated until the year 1944, but both of the parties in [fol 15] this case, or in this consolidated action, were very well aware that this action was pending, and nevertheless proceeded to continue their distribution of the dividends.

Respondent's contention is based on a trust fund doctrine, which was ruled* on by this Court in *Hal C. Smith*, 1948 case, 11 T. C. 174, wherein this Court held that a transferee of assets receives these assets from the transferor, impressed with a trust for the benefit of the transferor's creditors. Now, we feel that this position was not perhaps pressed upon the court, or was not at least considered in the opinion of this *Switlik* case and we do concede that the facts are very much within that decision, and that the decision is against the Government, but we have not acquiesced in it and the case is on appeal. We feel that especially in this case, where the petitioners knew that this action was pending against them and that it might go against them, and they proceeded nevertheless over a period of years to completely liquidate a corporation, that they are more specially impressed with the trust than was perhaps the case in this *Switlik* case, and that they can not now say that it was just an ordinary loss.

Official Report of Proceedings before the Tax Court of the United States, pages 8, 9, 10.

* Erroneously transcribed as "rebid".

[fol. 16] IN THE TAX COURT OF THE UNITED STATES

(FROM DEFICIENCY NOTICE ATTACHED TO PETITION
IN BAUER CASE, DOCKET NO. 24393)

Adjustments to Net Income

Net income as disclosed by return	\$ 1,070.73
Unallowable deductions and additional income:	
(a) Judgment loss	\$47,963.27
(b) Farm loss	1,400.00
(c) Medical expenses	486.66
	<hr/>
Total	\$50,920.66

Nontaxable income and additional deductions:

(d) Capital gain	\$17,627.31	
(e) Contributions	634.08	18,261.39
	<hr/>	<hr/>

Net income as adjusted	\$32,659.27
------------------------	-------------

Explanation of Adjustments

(a) In your return you deducted as an ordinary loss \$47,963.27, representing the payment of a judgment. It is determined that this loss represents a capital loss, deductible as provided by Section 117 of the Internal Revenue Code.

(d) As a result of adjustment (a), *supra*, the net capital gain of \$16,627.31 reported in Schedule D of your return has been adjusted to an allowable net capital loss of \$1,000.00, determined as follows:

Net capital gain as disclosed by return	\$16,627.31
---	-------------

Deduct:

Long-term capital loss allowed for
the reason stated in adjustment
(a), *supra* (50% of \$47,963.27). \$23,981.64

Add:

Decrease in capital loss carry-over
resulting from decrease in capital
loss claimed on return filed by
Frederick R. Bauer in respect of
the year 1942 917.22 23,064.42

Net capital gain corrected to net capital loss \$ 6,437.11

Limited capital loss allowable under section 117
(d) (2) of the Internal Revenue Code \$ 1,000.00
Net capital gain as disclosed by return 16,627.31

Decrease in income \$17,627.31

[fol. 17] IN THE TAX COURT OF THE UNITED STATES

(FROM DEFICIENCY NOTICE ATTACHED TO PETITION
IN VIVIAN CASE, DOCKET NO. 24394)

Adjustments to Net Income

Net income as disclosed by return \$(12,864.39)

Unallowable deductions and additional
income:

(a) Judgment loss \$47,963.25
(b) Rental loss 333.33
(c) Medical expenses 719.23 49,015.81

Total \$ 36,151.42

Nontaxable income and additional deductions:

(d) Capital gain	\$13,990.46	
(e) Contributions	350.00	14,340.46
		<hr/>
Net income as adjusted		\$ 21,810.96

Explanation of Adjustments

(a) In your return you deducted as an ordinary loss \$47,963.25, representing the payment of a judgment. It is determined that this loss represents a capital loss, deductible as provided by Section 117 of the Internal Revenue Code.

(d) As a result of adjustment (a), *supra*, the net capital gain of \$12,990.46 reported in Schedule D of your return has been adjusted to an allowable net capital loss of \$1,000.00, determined as follows:

Net capital gain as disclosed by return	\$ 12,990.46
Less: Long-term capital loss allowed for the reason stated in adjustment (a), <i>supra</i> (50% of \$47,963.25)	23,981.63
	<hr/>
Net capital gain corrected to net capital loss	\$ 10,991.17
	<hr/>
Limited capital loss allowable under section 117(d) (2) of the Internal Revenue Code	\$ 1,000.00
Net capital gain as disclosed by return	12,990.46
	<hr/>
Decrease in income	\$ 13,990.46

[fol. 17a] THE TAX COURT OF THE UNITED STATES

Docket No. 24394

MARY STEWART VIVIAN, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 24393

FREDERICK R. BAUER and RUTH R. BAUER, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

STIPULATION OF FACTS—Filed May 22, 1950

It is hereby stipulated and agreed by and between the parties, by their respective counsel, that the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be true:

1. Petitioner Mary Stewart Vivian is an individual residing at 789 Belvidere Avenue, Plainfield, New Jersey. Her income tax return for the year 1944 was filed with the Collector of Internal Revenue for the Second District of New York. A photostatic copy of said return is attached hereto marked Ex. 1-A, and by this reference made a part hereof. Said petitioner was the wife of Davenport Pogue who died on September 17, 1937. She married Leslie L. Vivian some time subsequent to 1940.

2. Petitioners Frederick R. Bauer and Ruth R. Bauer are husband and wife, residing at Lakeville, Connecticut. Their joint return for the year 1944 was filed with the Collector of Internal Revenue for the Second District of New York. A photostatic copy of said return is attached hereto marked Ex. 2-B and by this reference made a part hereof.

[fol. 17b] 3. A corporation known as Bauer, Pogue and Co., Inc. was organized in April of 1933 under the laws of the State of Delaware. One-half of the stock of said corpo-

ration was issued to Frederick R. Bauer, and one-half thereof to Davenport Pogue. Upon the death of said Davenport Pogue on September 17, 1937, one F. Donald Arrowsmith was appointed executor of his Last Will and Testament, and the 50% share of the stock of said corporation belonging to said decedent was transferred to the Estate of Davenport Pogue, Deceased.

4. Said corporation began the first of a series of distributions in complete liquidation on or about December 15, 1937, and made further distributions in liquidation in the years 1938, 1939 and 1940. The last of said distributions in complete liquidation was made in 1940. All such distributions were made as follows: one-half thereof to Frederick R. Bauer, petitioner herein, and the other one-half, representing the shares formerly owned by Davenport Pogue were distributed in 1937 and 1938 to the Estate of Davenport Pogue, Deceased, and in 1939 and 1940 to his widow, Mary Stewart Pogue (now Vivian), petitioner herein, as heir of said estate.

5. Said distributions for the years 1937, 1938, 1939 and 1940 to Frederick R. Bauer were reflected in the income tax returns of said petitioner for those years. Photostatic copies of said returns of Frederick R. Bauer for 1937, 1938, 1939 and 1940 are attached hereto marked Ex. 3-C, and by this reference made a part hereof.

6. In the case of the 50% interest formerly owned by Davenport Pogue, no report of the liquidating dividend for 1937 was shown in the return of the Estate of Davenport Pogue, Deceased, for said year. For the year 1938, the distribution made in said year was reflected in the income tax return of the Estate of Davenport Pogue, Deceased. A photostatic copy thereof is attached hereto marked Ex. 4-D and by this reference made a part hereof. For the years 1939 and 1940 the liquidating dividends representing the Pogue interests paid to Mary Stewart Pogue (now Vivian) were reflected in her income tax returns. Photostatic copies [fol. 17c] of said returns are attached hereto marked Ex. 5-E and by this reference made a part hereof.

7. The total liquidating distributions paid to each petitioner herein during the years 1937 to 1940, inclusive, exceeded the sum of \$47,963.25.

8. On or about June 8, 1939, an action was commenced in the Supreme Court of the State of New York by Adele D. Trounstine as Ancillary Executrix of the Last Will and Testament of one Norman S. Goldberger as plaintiff, against Bauer, Pogue & Co., Inc., Frederick R. Bauer, and F. Donald Arrowsmith as Executor of the Last Will and Testament of Davenport Pogue as defendants, which said action was thereafter transferred to the District Court of the United States for the Southern District of New York because of diversity of citizenship. Said action resulted in a judgment in favor of the plaintiff therein, which decision was subsequently affirmed on appeal by the Circuit Court of Appeals in and for the Second Circuit. (Trounstine v. Bauer, Pogue & Co., (CCA-2, 1944) 144 F. (2d) 379.) Certiorari was thereafter applied for and denied (Bauer, Pogue & Co., Inc. v. Trounstine, (1944) 323 U. S. 777). A copy of the transcript of the record in said proceeding is attached hereto marked Ex. 6-F and by this reference made a part hereof.

9. Thereafter, on December 11, 1944, after the judgment in said proceeding had become final, each of the petitioners herein was required to, and did pay, one-half of said judgment. The net amount of said judgment, after certain credits and adjustments, was in the amount of \$95,926.52, inclusive of interest and costs. The payment made by each of petitioners Frederick R. Bauer and Mary Stewart Vivian was the sum of \$47,963.25.

10. Each of the petitioners herein incurred medical expenses in the amounts set forth in their income tax returns for 1944.

(S.) George R. Sheriff, Counsel for Petitioners;
Charles Oliphant, Chief Counsel, Bureau of
Internal Revenue.

[fol. 18] UNITED STATES COURT OF APPEALS FOR THE SECOND
CIRCUIT, OCTOBER TERM, 1951

Nos. 78-79

(Argued December 11, 1951. Decided January 10, 1952)

Docket Nos. 22077-22078

[Title omitted]

Before Chase, Clark and Frank, Circuit Judges

Petition to review a decision of the Tax Court of the
United States. Reversed.

[fol. 19] Theron Lamar Caudle, Ellis N. Slack, Helen
Goodner and Edward J. P. Zimmerman (argued by Morton
K. Rothschild) for petitioner;
George R. Sherriff for respondents.

The facts and decision of the Tax Court are reported
in 15 T. C. 876.

OPINION—January 10, 1952

FRANK, Circuit Judge:

The liabilities which, in 1944, the taxpayers incurred
under the judgment and paid, were directly related to—
and would not have existed except for—the capital dis-
tributions made by the corporation to those taxpayers in
earlier years. Those liabilities, in other words, represent
“merely diminution in the capital gain received on the dis-
tribution” theretofore made.¹ The two are tied together,
and therefore the deductions in 1944 should be treated
as capital losses.

In so holding, we disagree with *Commissioner v. Switlik*,
184 F. (2d) 299 (C. A. 3). The court there, relying on
North American Oil Consolidated Co. v. Burnet, 286 U. S.
417, rested its decision on what has been called “the theory

¹ See Judge Disney, dissenting, in *Switlik v. Commis-
sioner*, 13 T. C. 121; 127-128.

of the single year as the unit of taxation"² and the resultant principle that a tax return for a previous year may not be reopened to reflect a subsequent fact. But we think that this now well-settled principle³ does not mean that [fol. 20] an examination of the previous year's return may not be made in order to determine the nature of the new fact for the purpose of ascertaining how a gain or loss is to be categorized in computing taxable income for the year in which the new fact happened.⁴ So here, considering together the events of the previous year and of the taxable year, the loss in the taxable year show up as arising out of a "sale or exchange."

2. Bauer argues that his payment of half the judgment was fully deductible, in any case, because made pursuant to a personal judgment against him, which he would have had to pay regardless of any liquidating distributions he received. See *Trounstone v. Bauer, Pogue & Co., Inc.*, 144 F. (2d) 379 (C. A. 2). We agree that the payment of a judgment against a corporate officer in these circumstances would ordinarily be deductible as a straight income loss. Here, however, Bauer was also liable, as a transferee, for the amount paid out, and that liability (we have held above) was an integral part of the original liquidation transfer, and so deductible as a capital loss only. We think, therefore, that the accidental fact that Bauer was liable both as an officer and as a transferee, did not give him the option of picking which liability he would satisfy, according to its tax consequences, when, as here, satisfaction of one liability discharged the other. For our purposes, the fact that he was personally liable for the judgment is superfluous; his fundamental position in regard to the 1944 payment was no different from that of the other transferee.

Reversed.

² 64 Harv. L. Rev. 858, 859 (1951).

³ See, *U. S. v. Lewis*, 340 U. S. 590; *Burnet v. Sanford & Brooks Company*, 282 U. S. 359; *St. Regis Paper Co. v. Higgins*, 157 F. (2d) 884 (C. A. 2) cert. den. 330 U. S. 843.

⁴ Cf. *Westover v. Smith*, 173 F. (2d) 90 (C. A. 9); *Commissioner v. Carter*, 170 F. (2d) 911 (C. A. 2).

[fol. 21] UNITED STATES COURT OF APPEALS

JUDGMENT—Filed January 10, 1952

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

F. DONALD ARROWSMITH, and RUTH R. BAUER, Executors,
etc., et al., Respondents

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[File endorsement omitted.]

[fol. 22] UNITED STATES COURT OF APPEALS

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

MARY STEWART VIVIAN, Respondent

JUDGMENT—Filed January 10, 1952

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court

of the United States be and it hereby is reversed in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[File endorsement omitted.]

[fols. 22-26] PETITION FOR REHEARING COVERING 4 PAGES
FILED JANUARY 24, 1952. OMITTED FROM THIS PRINT. IT
WAS DENIED, AND NOTHING MORE BY ORDER—FEBRUARY 11,
1952.

[fol. 28] UNITED STATES COURT OF APPEALS

[Title omitted]

ORDER ON REHEARING—Filed February 1952

Per CURIAM:

Harrie B. Chase, U.S.C.J.; Charles E. Clark, U.S.
C.J.; Jerome N. Frank, U.S.C.J.

[File endorsement omitted.]

[fol. 29] UNITED STATES COURT OF APPEALS

[Title omitted]

ORDER DENYING REHEARING—Filed February 11, 1952

A petition for a rehearing having been filed herein by
counsel for the respondents,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

[File endorsement omitted.]

[fol. 30] Clerk's Certificate to foregoing transcript omitted
in printing.

[fol. 29] IN THE SUPREME COURT OF THE UNITED STATES

STIPULATION

It is hereby stipulated and agreed between the parties hereto through their respective counsel of record as follows:

1. That the printed record herein shall consist of the record heretofore filed in connection with the petition for writs of certiorari, with the addition of the stipulation of facts which was filed in The Tax Court of the United States and the present stipulation.

2. All of the original exhibits, 1A to 6F inclusive, filed with The Tax Court and referred to in the stipulation of facts, and which were a part of the record on appeal before the United States Court of Appeals, Second Circuit, shall, together with such stipulation of facts, be forwarded by the Clerk of The Tax Court to the Clerk of the Supreme Court of the United States for use in the present proceeding. Either of the parties hereto may refer in his brief to the original exhibits and any other portions of the record filed in the Supreme Court.

George R. Shieriff, Counsel for Petitioners; Philip B. Perlman, Solicitor General, Counsel for Respondent.

[fol. 30] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1951

No. 753

F. DONALD ARROWSMITH and RUTH R. BAUER, Executors,
etc., et al., Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—Filed June 9, 1952

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted. The case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(2472)